

## REPORT FOLLOW-UP

**AGENCY: DEPARTMENT OF CORRECTION – CORRECTIONAL INDUSTRIES**

On January 29, 2004, the Legislative Services Office released an audit report for the Idaho Department of Correction, Correctional Industries for fiscal years 2002 and 2003. Legislative Audits contacted Correctional Industries on May 3, 2004. This report focuses on Correctional Industries' progress in resolving the three findings and recommendations contained in the audit report.

**STATUS OF RECOMMENDATIONS:**

**Finding #1:** Correctional Industries does not follow their policy for collecting outstanding accounts receivable. Correctional Industries' policy requires contacting customers with invoices 60 days or older; however, this has not happened on a regular basis. Also, monthly statements are not sent to customers. Accounts receivable should be regularly monitored to help ensure payments are collected in a timely manner. The risk of financial loss increases the longer accounts remain outstanding, and the opportunity for investment earnings is reduced. Accounts receivable balances older than 60 days at fiscal year-end 2002 and 2003 were \$238,441 and \$230,716, respectively. Corresponding amounts of \$182,955 and \$112,066 were more than 90 days old. Some of these amounts may be related to Correctional Industries not following its collection policy for outstanding accounts receivable.

**We recommended that Correctional Industries pursue and collect accounts receivable by monitoring the accounts to initiate follow-up in a timely manner, adhering to its follow-up and collection policy, and sending monthly statements to customers. We also recommended that Correctional Industries document compliance with its policies.**

**Audit Follow-up:** Correctional Industries has complied with its policies. Accounts receivable are now monitored monthly. Past due letters with accompanying statements and invoices are sent monthly to customers with balances over 30 days old. Members of the sales staff contact customers with balances over 60 days old. In addition to the past due letters, customers with balances over 90 days old are contacted regularly by phone. Customers with balances over 120 days old receive final notice letters and sales to these customers are terminated and their accounts are forwarded to the Attorney General or a collection agency, as necessary. All customer contact related to collection is documented.

Correctional Industries has collected \$141,152 of the \$230,716 in accounts receivable that were more than 60 days old as of June 30, 2003. The remaining \$89,564 is made up of six customers. Correctional Industries has recently engaged the services of the Deputy Attorney General at the Idaho Department of Corrections to assist in the collection efforts for these accounts.

The current accounts receivable at April 30, 2004, that were over 60 days old are \$261,633, with \$235,447 of this amount over 90 days old. Although accounts receivable have increased, Correctional Industries expects to collect \$88,000 from accounts over 90 days old within the next 30 days and is actively pursuing payment on all accounts.

**Status: IN-PROCESS**

**Finding #2:** Correctional Industries has no policy or support for allowances and other reserves. Correctional Industries' maintained a \$15,000 allowance for doubtful accounts receivable, a \$46,000 allowance for obsolete materials inventory, and an \$85,020 reserve for warranty expenses. However, Correctional Industries could provide no basis for these amounts or policy governing the establishment and periodic review of allowances and reserves. Subsequent to the audit period, Correctional Industries determined the correct allowance for obsolete materials inventory was \$205,000, and added a one-time \$159,000 write-down of inventory value for fiscal year 2003. Correctional Industries is also analyzing other allowance and reserve amounts to determine if they are reasonable. A formal policy regarding the establishment and periodic review of allowance and reserve amounts helps ensure there is a reasonable basis for the estimates.

**We recommended that Correctional Industries complete a policy for determining all allowance and reserve amounts and for reviewing these amounts at least annually.**

**Audit Follow-up:** Correctional Industries has taken the following steps: (1) developed an estimate for warranty reserves based on actual warranty costs as a percentage of sales for each of the previous four fiscal years; (2) established an historical basis to determine the appropriate allowance amount for doubtful accounts receivable; and (3) identified obsolete materials inventory items that have not been used in over a year based on reports produced from the accounting inventory records. Appropriate adjustments have been made to the financial statements for each of the reserve accounts. These procedures will now be formalized and will address monitoring, estimate calculations, and the frequency of review.

**Status: IN-PROCESS**

**Finding #3.** Some financial information may be inaccurate due to accounting errors and lack of review. Correctional Industries maintains financial information for each of its shops. Some accounting entries and transactions for the shops were not monitored or reviewed closely enough. Following are some examples:

- There was no documented support to explain a \$23,100 and a \$37,600 adjustment for cattle inventory.
- Hay received and used was not properly recorded, which caused monthly shop financial statements to be inaccurate and misleading. However, year-end combined financial statements were accurate.
- There was no documented basis for annual administrative overhead allocations of about \$1.5 million between shops. However, the allocations netted to zero in Correctional Industries year-end combined financial statements.

The basis for some adjustments and unreconciled amounts were later determined. However, Correctional Industries should provide better monitoring and documentation explaining accounting entries, adjustments, and allocations.

**We recommended Correctional Industries monitor and review accounting entries and transactions more closely to reduce errors and increase the accuracy of financial information, as well as fully document all transactions for estimates and allocations.**

**Audit Follow-up.** The accounting manager or financial specialist review and approve all journal entries and adjustments prior to posting. An edit list produced from the accounting system, and supporting documentation, is used to support the review and approval process.

Correctional Industries is developing an administrative overhead allocation methodology for the fiscal year 2005 budget. The allocation will be based upon hours of direct labor by shop. The procedure for the allocation will be formally documented.

**Status: CLOSED**